

LETTER OF FINDINGS NUMBER: 03-0422
Income Tax
For the Years 1997-2001

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ISSUES

I. Gross Income Tax- Imposition

Authority: IC 6-8.1-5-1 (b), IC 6-2.1-2-2(a)(2), IC 6-2.1-1-2, 45 IAC 1-1-51, 45 IAC 1.1-6-2.

The taxpayer protests the imposition of gross income tax.

II. Adjusted Gross Income Tax-Imposition

Authority: IC 6-3-2-1, IC 6-3-2-2(a), 45 IAC 3.1-1-55.

The taxpayer protests the imposition of adjusted gross income tax.

III. Tax Administration- Ten Per Cent (10%) Negligence Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is a Delaware holding company. The taxpayer corporation receives its income from the licensing of its intellectual property and trademarks to affiliated companies that use the intellectual property in several states including Indiana. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax, interest, and penalty. The taxpayer protested the imposition of the tax and ten percent (10%) negligence penalty. A hearing was held. This Letter of Findings results.

I. Gross Income Tax- Imposition

DISCUSSION

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The taxpayer's first protest concerns the department's imposition of gross income tax on its income from Indiana. Indiana imposes a gross income tax on the "taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a)(2). For purposes of the gross income tax, "gross income" includes receipts from "the investment of capital, including interest, discounts, rentals, royalties, dividends, fees, and commissions." IC 6-2.1-1-2.

Under the regulations governing the gross income tax, "taxable gross income" includes income that is derived from "intangibles." 45 IAC 1-1-51(1997 and 1998) 45 IAC 1.1-6-2 (1999-2001). The term "intangibles" includes:

Notes, stocks in either foreign or domestic corporations, bonds, debentures, certificates of deposit, accounts receivable, brokerage and trading accounts, bills of sale, conditional sales contracts, chattel mortgages, "trading stamps," final judgments, lease royalties, certificates of sales, choses in action, *and any and all other evidences of similar rights capable of being transferred, acquired or sold. (Emphasis added). Id.*

In order for Indiana to impose the gross income tax on income derived from the Delaware holding company's intangibles, the department must determine that the income is derived from a "business situs" within the state. *Id.* The regulation states that a taxpayer has established a "business situs" within the state "[i]f the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana. . . ." *Id.* Once the taxpayer has established a "business situs" within the state, "and the intangible or the income derived therefrom is connected with that business, either actually or constructively, the gross receipts of those intangibles will be required to be reported for gross income tax purposes." *Id.*

Clearly the taxpayer's gross income, the licensing fees received from its affiliated corporation, is income derived from a "business situs" in Indiana. The taxpayer's intellectual property is licensed to the Indiana affiliated corporation. The intellectual property is "localized" in Indiana in the sense that the affiliated corporation uses the intellectual property to increase the value of the products the affiliated corporation sells in Indiana at the affiliated corporations sales outlets and distribution centers. But for the sales by the affiliated corporation in Indiana, the taxpayer would not receive the income.

The taxpayer's intellectual property has acquired a business situs within Indiana. The income at issue is connected with that business as contemplated by the Indiana statute imposing the gross income tax. Therefore, the department properly imposed the gross income tax on the taxpayer's licensing fees.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Imposition

DISCUSSION

The taxpayer also protests the imposition of the adjusted gross income tax.

Indiana imposes an adjusted gross income tax on "that part of the adjusted gross income derived from sources within Indiana of every nonresident person." IC 6-3-2-1. The legislature has defined "adjusted gross income at IC 6-3-2-2(a) as follows:

(1) income from real or tangible property located in this state; (2) income from doing business in this state; (3) income from a trade or profession conducted in this state; (4) compensation for labor or services rendered within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

The taxpayer and the department agree that the taxpayer receives income from the licensing of its intellectual property, trademarks, from its affiliated corporation in Indiana. The issue is whether or not this income is derived from a source within Indiana so it is subject to the adjusted gross income tax. This issue is clarified by 45 IAC 3.1-1-55 as follows:

The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property.

The taxpayer licenses the intellectual property for use by its affiliated companies, deriving value from the ability to place the trademarks at retail locations in various states. The value attaches to the trademarks solely upon use at those retail and distribution locations including those in Indiana. Apart from the use in those locations, the trademarks would have no significant value. There would be no payments or income received by the taxpayer if the trademarks were not attached to products sold in Indiana locations. The income is inextricably connected with the affiliated corporation's retail outlets and distribution centers in Indiana. This constitutes a "business situs" subjecting the subject income to the Indiana adjusted gross income tax.

FINDING

The taxpayer's protest is denied.

III. Tax Administration- Ten Percent (10%) Negligence Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to reach and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The taxpayer disregarded its duty to file an Indiana corporate income tax return. This breach of the taxpayer's duty constituted negligence.

FINDING

The taxpayer's protest is denied.

KMA/PLER/05/10/02